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The economics of crowd out under mixed public/private health insurance*

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Abstract. It is well known that public insurance sometimes crowds out private insurance. Yet, the economic theory of crowd out has remained unstudied. Here, I show that crowd out causes two countervailing effects: (a) the *intensive margin effect*–since high demanders are crowded out, the private market now has a larger proportion of low demanders on the intensive margin (The intensive margin are those who have already bought private insurance), and so will drop quality to lower the price to the low demanders' liking; and (b) the *extensive margin effect*–before the public insurance expansion, the private sector had lowered quality to make insurance more affordable at the extensive margin (The extensive margin is the next group of people who would buy private insurance if the price decreased), but now that public insurance crowds out the extensive margin, quality can then be raised back up to the high demanders' liking.

If the extensive margin effect dominates, then a new phenomenon of *push out* occurs, in which crowd out causes the private sector to raise quality and to *increase* the number of uninsured low demanders not eligible for public insurance. If the intensive margin effect dominates, then crowd out will cause the private sector to lower quality, causing the phenomenon of *crowd-in*, in which the number of uninsured low demanders that take-up private insurance increases.

These two countervailing effects have important implications for any government policy that desires to eradicate all uninsurance. First, if push out is dominant, then the private sector will respond to the public insurance by pushing out and leaving some people newly uninsured. If crowd-in is dominant, then all people can be insured and the government can do it at a lower-than-anticipated level of expansion due to the private sector crowding in.

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